Privatizing "Outsider Trading"*

KIMBERLY D. KRAWIEC**

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I. INTRODUCTION

In this article, I propose the privatization of "outsider trading" law by arguing that regulators should leave issues regarding the permissibility of insider trading by corporate outsiders to state

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* The ideas presented in this article form part of a larger work, Kimberly D. Krawiec, *Fairness, Efficiency & Insider Trading: Deconstructing the Coin of the Realm in the Information Age*, 95 NW. U. L. REV. 443 (2000).

** Visiting Professor, University of Pennsylvania Law School; Professor, University of North Carolina School of Law. A prior draft of this article was presented at the Sixteenth Annual Sokol Colloquium on Private International Law at the University of Virginia School of Law and I am grateful to the participants at that conference for their helpful comments and questions.

contract law, rather than to federal securities law.[1] Furthermore, I argue that states should avoid the confusion engendered by the United States Supreme Court's interpretation of outsider trading liability under *United States v. O'Hagan*, by imposing insider trading liability on corporate outsiders only when such trading contravenes an express agreement.

In making these arguments, I take issue with the proposal that federal insider trading regulation should seek to protect issuers' property rights in valuable information. In addition, I argue that, despite arguments by some commentators that in *United States v. O'Hagan* the United States Supreme Court eliminated all regulatory distinctions between insider and outsider trading, sound policy reasons exist for such a distinction between the trading activities of corporate insiders, who control the issuer's information flow to the marketplace, and corporate outsiders, who lack such control.[2]

The notion that federal insider trading regulation is or should be designed to protect issuers against the theft of corporate intellectual property has gained increasing acceptance in recent years, particularly among legal scholars concerned with promoting the informational efficiency of U.S. securities markets.[3] Such an intellectual property regime, it is argued, will encourage issuers to produce the socially optimal amount of information by allowing information creators to profit from that activity.[4]

1. As used in this article, the phrase "insider trading" refers to "all trades where information is asymmetric," regardless of whether the trader is an actual corporate insider and regardless of the legality of the trade. *See* Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 860 (1983). Outsider trading is defined *infra* note 8 and accompanying text.

2. *See* Saikrishna Prakash, *Our Dysfunctional Insider Trading Regime*, 99 COLUM. L. REV. 1491, 1493 (1999) (arguing that the misappropriation theory adopted by the Supreme Court in *United States v. O'Hagan* governs both insider and outsider trading liability under Rule 10b-5). *But see* Stephen M. Bainbridge, *Insider Trading*, *in* 3 ENCYCLOPEDIA OF LAW & ECONOMICS 772 (Boudewijn Bouckaert & Gerritt De Geest eds., 2000) (rejecting this argument).

3. *See* Bainbridge, *Insider Trading*, *supra* note 2, at 791 ("There is an emerging consensus that the federal insider trading prohibition is most easily justified as a means of protecting property rights in information.").

4. *See, e.g.*, United States v. Chestman, 947 F.2d 551, 576–77 (2d Cir. 1991) (Winter, J., dissenting); David D. Haddock & Jonathan R. Macey, *A Coasian Model of Insider Trading*, 80 NW. U. L. REV. 1449 (1987) [hereinafter Haddock & Macey, *Coasian Model*]; David D. Haddock & Jonathan R. Macey, *Regulation on Demand: A Private Interest Model, with an Application to Insider Trading Regulation*, 30 J.L. & ECON. 311 (1987); Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9 (1984) [hereinafter Macey, *New Directions*].

Current insider trading law in many ways closely resembles just such a regime. The fraud-on-the-source version of the misappropriation theory, adopted by the Supreme Court in *United States v. O'Hagan*, goes a long way toward regulating the "theft" of valuable inside information.[5]

Some legal scholars have vigorously criticized the idea that insider trading regulation should seek to protect issuers' rights in valuable information, by arguing that the federal securities laws are designed to protect investors and promote fairness in the federal securities markets, rather than to protect issuers' intellectual property rights.[6] This article, however, follows a different approach by arguing that, despite its proponents' tendency to frame their arguments in terms of promoting informational efficiency, a legal regime treating inside information as the property of the issuer is unlikely to further that goal. In fact, such proposals ignore important case law, legislative precedent, and the substantial body of scholarly work in the intellectual property field, by assuming an affirmative answer to a question that is fiercely debated in other areas of intellectual property law: does creating a property right in information producers sufficiently incentivize additional production to offset the social costs of excluding others from using the information?

After analyzing the costs and benefits of an insider trading regime that grants intellectual property rights to issuers, this article

5. In other respects, however, current law does not resemble a system of private property rights in issuers. *See, e.g.*, Jill E. Fisch, *Start Making Sense: An Analysis and Proposal for Insider Trading Regulation*, 26 GA. L. REV. 179, 223 n.196 (1991) (noting that if the prospective bidder in a tender offer tips a friend about the upcoming tender offer and advises the friend to purchase target shares, the friend will be guilty of insider trading under rule 14e-3 and the rule, therefore, is inconsistent with a property-rights approach to insider trading liability). Similarly, the classical theory of insider trading liability, unlike an intellectual property rights regime, does not permit the issuer or its shareholders to grant insider trading rights to others, such as corporate insiders, a point forcefully criticized by advocates of such a rule. *See, e.g.*, Haddock & Macey, *Coasian Model*, *supra* note 4, at 1450–51; JONATHAN R. MACEY, INSIDER TRADING: ECONOMICS, POLITICS AND POLICY 39–42 (1991).

6. *See* Roberta S. Karmel, *Outsider Trading on Confidential Information—A Breach in Search of a Duty*, 20 CARDOZO L. REV. 83, 113 (1998) ("The easiest criticism of the property rights theory is that when Congress passed and subsequently amended the Exchange Act, it was concerned about fairness and the protection of investors, not the protection of property rights in information held by issuers and traders."); Fisch, *supra* note 5, at 225–26 (noting that although the property rights approach focuses on harm to the source of information or to the issuer, consistent with the classical and misappropriation theories, this does not seem consistent with the real reason we prohibit insider trading, which is a perceived unfairness to investors).

concludes that the costs exceed the benefits and such a regime, therefore, cannot be justified as a means of promoting informational efficiency. This conclusion rests on three separate bases. First, the view that the grant of private property rights in information producers will lead to the optimal level of information production and dissemination has been widely disputed by economists and legal scholars. Second, due to the possibility of multiple uses for information, it is doubtful that issuers would discontinue or reduce information production in the absence of a property right. Third, the American legal system has shown a general reluctance to recognize property rights in raw information, in the belief that such an endowment would restrict information distribution.

Although issuers need no added incentive to create valuable inside information, the need to encourage the dissemination of such information to the marketplace has been recognized for many years.[7] Accordingly, I propose a system of federal securities regulation that would permit insider trading by corporate outsiders, defined as those persons who are neither employees nor constructive insiders of the issuer and who did not receive their information in a tip from the issuer's employees or constructive insiders.[8] Such a system, I argue, provides the hope of filling in the gaps left by the current "disclose or abstain" regulatory system, by encouraging the reflection of certain information in stock market price without requiring disclosure of the actual inside information. Furthermore, this proposal leaves unchanged federal law regarding the trading and tipping activities of corporate insiders and constructive insiders—those parties who have assumed a fiduciary duty to the corporation and its shareholders and who often control the corporation's information flow to the outside world. Accordingly, this proposal avoids the perverse incentives and negative impacts on market efficiency attendant in a system that permits insider trading by such parties.[9]

7. Some commentators argue that regulatory incentives are necessary to induce managers to disclose the socially optimal amount of information, while others contend that market forces provide sufficient incentives. *See, e.g.*, sources cited *infra* note 62.

8. Tippees are liable for insider trading under rule 10b-5 only if they know or have reason to know that the information was given to them in breach of a fiduciary duty. *See* Dirks v. SEC, 463 U.S. 646 (1983) (finding that Dirks did not violate rule 10b-5 by trading on information provided by Equity Funding employees because the employees breached no fiduciary duty to Equity or its shareholders in conveying the information to Dirks).

9. *See infra* note 73 (discussing trading by corporate insiders).

Many corporate outsiders who come into contact with valuable inside information are in a contractual relationship with the issuer or its insiders and will be prevented by confidentiality agreements from trading on or disclosing the information acquired during the course of that relationship. Accordingly, this proposal does not "legalize" outsider trading so much as transfer the burden of enforcing such agreements to private parties and state courts from the Securities and Exchange Commission (SEC), which is currently overburdened and whose enforcement of such agreements has been costly and ineffective.

II. ENCOURAGING THE OPTIMAL LEVEL OF INFORMATION PRODUCTION AND DISSEMINATION

A. *The Collective Good "Problem"*

The notion that insider trading regulation should seek to protect issuers' intellectual property stems from the recognition that information presents the non-exclusivity problems common to a collective good: specifically, permitting access to those paying for the use of information while at the same time excluding non-payers is difficult.[10] Neoclassical economic theory asserts that this inappropriability of information prevents the information producer from capturing the full benefits of production, leading to decreased incentives for the production of information and a potential underproduction of the resource.[11]

This discussion of information as a collective good is intricately related to the voluminous scholarship on the "tragedy of the commons."[12] In fact, it has been explicitly noted that the "'field of ideas' bears a great similarity to a common."[13] The tragedy of the commons posits that, because common ownership prevents internalization of the full costs and benefits of an activity, it is likely to result in the tragedy of either overuse or undersupply of limited

10. *See* Harold Demsetz, *The Private Production of Public Goods*, 13 J.L. & ECON. 293, 295 (1970) (defining "collective good").

11. *See* Kenneth J. Arrow, *Economic Welfare and the Allocation of Resources for Invention*, *in* THE RATE AND DIRECTION OF INVENTIVE ACTIVITY: ECONOMIC AND SOCIAL FACTORS 609, 615 (National Bureau of Economic Research ed., 1962); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 32 (4th ed. 1992); ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 106–08 (3d ed. 2000).

12. *See* Garrett Hardin, *The Tragedy of the Commons*, *reprinted in* ECONOMIC FOUNDATIONS OF PROPERTY LAW 2, 4–5 (Bruce Ackerman ed., 1975).

13. Justin Hughes, *The Philosophy of Intellectual Property*, 77 GEO. L.J. 287, 315 (1988).

resources. In other words, when common rights to use a limited resource are shared, there is an incentive for overconsumption. Similarly, when a common obligation to provide a resource is shared, there is an incentive to underproduce.[14]

The neoclassicists' proposed resolution to the collective good problem is a system of private property rights in limited resources. Applying this principle to information jurisprudence has led many observers to conclude that a system of private ownership of valuable information is necessary to avoid the perceived problem of underproduction of information.[15] In fact, United States patent and copyright law are largely based on the perception that authors, inventors and other producers of creative work will not produce the optimal amount of inventive and artistic labor, and that publishers and other distributors will not disseminate such work, in the absence of property rights.[16]

Relying on these theories, legal commentators advocating an insider trading rule that furthers informational efficiency have tended to converge on the notion that insider trading regulation should seek to protect issuers' property rights in valuable inside information. This, it is argued, will enhance informational efficiency by allowing issuers to profit from their creation of information, thus eliminating the problems associated with the inappropriability of information and encouraging issuers to produce the socially optimal amount of information, by allowing issuers to profit from their creations.

B. *Challenges to the Neoclassical View of Informational Property*

Even if neoclassical economic scholars are correct in their assertion that most resources are optimally produced and used in a system of private ownership, it is not clear that the same is true with regard to the use and production of information.[17]

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14. PAUL MILGROM & JOHN ROBERTS, ECONOMICS, ORGANIZATION & MANAGEMENT 294 (1992).

15. *See* Anthony T. Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEGAL STUD. 1, 2 (1978); William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325, 327–28 (1989); Macey, *New Directions*, *supra* note 4, at 40.

16. *See* Landes & Posner, *supra* note 15, at 328.

17. An analysis of the voluminous scholarly work on the benefits of communal, as opposed to private, ownership is beyond the scope of this paper. Nonetheless, it should be noted that the neoclassical economic assertion that private ownership results in the most efficient use and allocation of resources has not gone unchallenged. *See, e.g.*, Robert C. Ellickson, *Property in Land*, 102 YALE L.J. 1315, 1318 (1993) (discussing successful

Information allows marketplace actors to rationally choose among available resources. Information, therefore, is valuable and shares some similarities with other commonly bought and sold commodities. Unlike other valuable commodities, however, information is also central to efficiently functioning markets. In fact, so central is information to the ability of individuals to interact intelligently with one another that the presence of "perfect information" is one of the core assumptions of much economic theory.[18]

As noted by economists and legal scholars, however, these two competing roles played by information—a necessary precondition to efficient markets and a scarce commodity within the market whose production must be encouraged—are difficult to reconcile. If markets are to be perfectly efficient, then information must be perfectly and costlessly available.[19] If information is "costless," however, then there is no profit potential for the producer of information.[20] Granting property rights to the producers of information may enable them to capture the benefits of production and

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collectivization attempts in Israel, Russia, China, Ethiopia and Kampuchea, and by more discrete groups, such as Protestant sectarians and hippie communes); *id.* at 1397–98 (arguing that members of small, closely-knit groups tend to create cost-minimizing land regimes that incorporate a mix of private, group and open-access spaces and that some resources, for scale-economy or risk-sharing reasons, may be more efficiently owned in common form); Duncan Kennedy & Frank Michelman, *Are Property and Contract Efficient?*, 8 HOFSTRA L. REV. 711, 717–20 (1980) (arguing that production of resources may be maximized in a "state of nature" as opposed to through a system of private ownership); Carol Rose, *The Comedy of the Commons: Custom, Commerce, and Inherently Public Property*, 53 U. CHI. L. REV. 711, 718–23 (1986) (contending that some resources, such as roads, waterways and beaches may be most efficiently owned as common property).

18. *See* GEORGE J. STIGLER, THE THEORY OF PRICE 87 (3d ed. 1966) ("A perfect market is one characterized by perfect knowledge on the part of the traders."); James Boyle, *A Theory of Law and Information: Copyright, Spleens, Blackmail, and Insider Trading*, 80 CAL. L. REV. 1413, 1443 (1992) (arguing that "the concept of 'perfect' information—meaning free, complete, instantaneous, and universally available—[is] one of the defining features of the perfect market").

19. *See* Sandford J. Grossman & Joseph E. Stiglitz, *On the Impossibility of Informationally Efficient Markets*, 70 AM. ECON. REV. 393, 405 (1980); Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 552 (1984). Professors Gilson and Kraakman, in their groundbreaking work on market efficiency, rephrased the debate as an attempt to explain why and how markets behave *as if* information is immediately and costlessly available, even when it is not. *See id.*

20. *See* Gilson & Kraakman, *supra* note 19, at 571; Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges and the Production of Information*, 1981 SUP. CT. REV. 309, 313 ("A rule allowing information to be used freely, once in existence, may well maximize the wealth of both the users and society. Yet the same rule would reduce the ability of those who create information to appropriate the benefits of their efforts; people would create less information . . . .").

encourage the creation of information. Intellectual property rights, however, introduce a transaction cost into the marketplace, impeding the free flow of information.[21] As stated by Professors Grossman and Stiglitz:

> There is a fundamental conflict between the efficiency with which markets spread information and the incentives to acquire information. . . . [B]ecause information is costly, prices cannot perfectly reflect the information which is available, since if it did, those who spent resources to obtain it would receive no compensation.[22]

C. *Board of Trade of the City of Chicago v. Dow Jones & Co.*

This tension between information as a precondition to fully informed efficient markets and information as a valuable commodity within the market is illustrated by the case of *Board of Trade of the City of Chicago v. Dow Jones & Co.*[23] In *Dow Jones*, the Chicago Board of Trade attempted to create and market a commodity futures contract based on the Dow Jones Industrial Average.[24] The index futures prices at issue in the case present a

21. *Cf.* Gilson & Kraakman, *supra* note 19, at 593 (demonstrating that with lower information costs, information will be more widely distributed and will be more efficiently reflected in market price).

22. Grossman & Stiglitz, *supra* note 19, at 405. Kenneth Arrow demonstrated this tension between social welfare and private incentives by arguing that, while making information available enhances social welfare free of charge, this results in a lack of incentives for private information production. *See* Arrow, *supra* note 11, at 616–17. While a grant of private property rights in information producers would incentivize production, "precisely to the extent that it is successful, there is an underutilization of the information." *Id at* 617. Professors Grossman and Stiglitz resolved the "efficiency paradox" by proposing the existence of an "equilibrium degree of disequilibrium." Grossman & Stiglitz, *supra* note 19, at 393. They argued that "noise" prevented capital markets from ever reaching full efficiency, resulting in profit potential for informed traders and an incentive for information acquisition. *See id.* Professors Gilson and Kraakman expanded on this theory by recognizing that, due to temporal advantage, there is sufficient profit incentive to encourage the initial acquisition of new information. *See* Gilson & Kraakman, *supra* note 19, at 625. The paradox, therefore, was not how markets initially became efficient, but how they remained so. *See id.* They demonstrated that the costs of maintaining the equilibrium were virtually zero (because it was not dependant on new information discoveries, but rather on the continuing exploitation of prior discoveries) and that these costs in any event would probably be incurred in connection with other trading strategies. *See id.* at 624–25.

23. 456 N.E.2d 84 (Ill. 1983). *See* Boyle, *supra* note 18, at 1450. Professor Paul G. Mahoney has examined similar issues in connection with the prices and other information generated by stock exchanges. *See* Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453, 1483–88 (1997).

24. 456 N.E.2d at 85.

classic collective good problem: like most other creative works, the prices take significant amounts of time, labor and input to create, but once the information has been revealed it is available to others at nearly zero cost.[25] While recognizing the tension between information as property and information as a precondition to efficient markets,[26] the court nonetheless reasoned that if others could free ride on Dow Jones's efforts and use the prices at will, Dow would have a reduced incentive to create the prices. This reduced incentive, the court argued, posed the danger that Dow might withdraw from production, to the marketplace's detriment.[27] As has been demonstrated, one way to avoid this problem—and the method adopted by the court—is the creation of property rights in the information in question.[28] Granting one marketplace actor a limited monopoly over price information, however, imposes transaction costs on the distribution of an extraordinarily important piece of information relating to value—price[29]—leading to a potentially less efficient market.

Justice Simon explicitly addressed this concern in his dissenting opinion:

> [W]e must balance Dow Jones' interest in preventing the use of its average by the Board of Trade against society's interest in the widest use and dissemination of intellectual property. Obviously both interests are important and require fair consideration in the balancing process. Unless the creators of intellectual property . . . allow it to be appropriated by people who have developed novel and inventive uses for it, the pace of innovation will slow.... The majority errs, in part, because it has failed to place enough emphasis on the unfettered

25. *See* Boyle, *supra* note 18, at 1449.

26. *See* Dow Jones, 456 N.E.2d at 89 ("Competing with the policy that protection should be afforded one who expends labor and money to develop products is the concept that freedom to imitate and duplicate is vital to our free market economy.").

27. *See id.* at 89–90.

28. *See id.*; Boyle, *supra* note 18, at 1449–50.

29. *See* David E. Van Zandt, *The Market as a Property Institution: Rules for the Trading of Financial Assets*, 32 B.C. L. REV. 967, 981 (1991) ("In a market in which there are frequent trades of large numbers of identical assets, the previous or the currently quoted price is often the most significant information to which a trader has access. Traders can safely and cheaply form their expectations of the true value of the asset by examining the price."); Gilson & Kraakman, *supra* note 19, at 572–79.

> access to ideas in the public domain, a privilege that is essential to our free market economy.[30]

Accordingly, despite the fact that information presents the nonexclusivity problems of a public good, the extent to which intellectual property rights should be used to remedy that problem has been the subject of heated debate among economists and legal scholars. Insider trading scholars should bear this debate in mind when advocating an insider trading regime that treats inside information as the intellectual property of issuers.

III. MULTIPLE USES FOR INFORMATION

Even assuming that endowing information producers with private property rights does not unduly hamper information dissemination, it is not at all obvious that issuers need any extra incentive to produce information about themselves.[31] Economists and legal theorists have noted that the possibility of multiple profitable uses for the same information may provide sufficient incentives for information production, obviating the need for an endowment of property rights in information creators.

For example, Professor Jack Hirshleifer argued that the ability of information producers to speculate on price revaluations due to their inventions or discoveries could operate as sufficient compensation and incentive to information creation.[32] As such, the grant of property rights to information producers, through a patent or copyright, for example, would result in overcompensation to information producers and operate as an incentive to socially wasteful overproduction of information.[33]

Professor Hirshleifer used the example of Eli Whitney's cotton gin to illustrate this point.[34] Whitney spent much time and money attempting to protect his patent in the cotton gin, efforts that were largely unsuccessful.[35] Hirshleifer conceded that Whitney and other would-be inventors could have been discouraged by these results from pursuing subsequent inventions. On the other hand, if

30. Dow Jones, 456 N.E.2d at 91 (Simon, J., dissenting). Justice Simon also argued that the expansion of intellectual property rights should be left to Congress or to state legislatures, and not to the courts. *See id.*

31. *See* Stephen M. Bainbridge, INSIDER TRADING 167 (1999).

32. *See* Jack Hirshleifer, *The Private and Social Value of Information and the Reward to Inventive Activity*, 61 AM. ECON. REV. 561, 571 (1971).

33. *See id* at 572.

34. *See id.* at 570–71.

35. *See id.*

Whitney had been successful in his efforts to limit use of the cotton gin, cotton production and consumption would not have expanded as it did.[36] In other words, the reduction in possible future innovations may have been outweighed by the benefits of permitting the widest exploitation of the current technology.

This is particularly true if it is recognized that Whitney had numerous other means at his disposal to profit from his cotton gin invention. For example, rather than merely profiting from payments made by others in exchange for use of the technology (as under the patent system), Whitney could have allowed anyone to use his invention free of charge and profited instead from speculation on the impact that the cotton gin would have on the economy, such as the price of cotton, the value of slaves, and the profit potential of cotton producing or shipping firms.[37] This might have enabled both the socially optimal use and dissemination of the new innovation and provided sufficient incentives to encourage future invention.[38] Other commentators have also recognized that this possibility of multiple profitable uses for the same information may provide sufficient incentives for information production, obviating or reducing the need for exclusive private property rights in information.[39]

Similarly, Justice (at that time Professor) Stephen Breyer questioned the necessity of copyright protection for most books. He argued that because the original author can profit from sales while subsequent producers take the time to copy the original work, only a modest fall in revenues could be predicted in the absence of copyright protection, which he believed would be offset

36. *See id.*

37. *See id.* at 571.

38. *See id.* at 570–73.

39. *See, e.g.*, Harold Demsetz, *The Private Production of Public Goods*, 13 J.L. & ECON. 293, 306 (1970) (illustrating that, if consumption of a public good can be tied into consumption of a second good, then efficient production of the public good may be possible); Gilson & Kraakman, *supra* note 19, at 624–25 (arguing that traders may unavoidably incur the costs of acquiring information about past stock prices in connection with other trading strategies); Edmund W. Kitch, *The Law and Economics of Rights in Valuable Information*, 9 J. LEGAL STUD. 683, 717–19 (1980) (discussing the possibility for multiple uses of information and its role in incentivizing information production); Landes & Posner, *supra* note 15, at 331 ("Many authors derive substantial benefits from publication that are over and beyond any royalties."). Professors Landes and Posner, however, raise a variety of persuasive arguments negating the hypothesis that the possibility of alternate sources of profit obviates the need for patent and copyright protection. *See id.* at 331–32.

by the public's greater access to books.[40] Professor Breyer also noted that publishers had other means at their disposal to sustain revenues in the absence of copyright protection, including pre-publication contracts with buyers, negotiation with organized groups of buyers, and government subsidization of some works.[41]

Similar arguments apply to issuers and material inside information. Issuers create valuable information about themselves in order to operate a successful business enterprise, not in order to generate trading profits. Consequently, issuers are likely to engage in the same level of information production regardless of whether they are entitled to a property right in the information they create. Nothing is gained on the upside, therefore, by granting issuers a private property right in the information they produce. Much, however, is lost on the downside in terms of reduced informational access and dissemination. In other words, although granting issuers a private property right in information they create is unlikely to increase information production, it is likely to substantially decrease the public's access to information, resulting in reduced informational efficiency.

Finally, the arguments made by Justice Breyer regarding the protections available to authors and publishers outside of the copyright context, such as private contracts, hold equally true with regard to the valuable inside information produced by issuers. Issuers are likely to have contractual relationships with most potential misappropriators and have the power to bind third parties to refrain from trading on information learned in the context of the contractual relationship.[42]

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40. *See* Stephen Breyer, *The Uneasy Case for Copyright: A Study of Copyright in Books, Photocopies and Computer Programs*, 84 HARV. L. REV. 281, 309 (1970). *See also* Landes & Posner, *supra* note 15, at 330 ("Copying takes time, so there will be an interval during which the original publisher will not face competition."). Many other commentators have noted the fact that timing advantages weaken the argument for intellectual property protection, although they differ in the extent to which they believe first-mover advantages warrant eliminating or reducing intellectual property protection. For example, Professor Paul G. Mahoney has noted the importance of timing advantages in the context of stock exchanges. Mahoney writes:

> The creators of a market face free rider problems, but counterbalancing these are first- mover advantages, particularly in securities markets. Once an exchange begins to attract listings and investors, it can offer superior liquidity compared to the unorganized markets with which it competes, which will attract more companies and investors and strengthen its advantage.

Mahoney, *supra* note 23, at 1488

41. *See* Breyer, *supra* note 40, at 302.

42. *See infra* pp. 711–15 (advocating the privatization of outsider trading law).

IV. THE HISTORICAL AMERICAN APPROACH TO INFORMATIONAL PROPERTY

Finally, the American legal system's traditional reluctance to recognize property rights in information should, at the very least, cause a more careful consideration of the assertion that issuers are deserving of an exclusive property right in information about themselves. The historical American approach to informational property was best summarized by Justice Brandeis: "The general rule of law is, that the noblest of human productions—knowledge, truths ascertained, conceptions, and ideas—become, after voluntary communication to others, free as the air to common use."[43] While some areas of intellectual property law recognize that the need to incentivize production may at times require limits on the use of information, it has for the most part avoided characterizing raw information as property.

For example, while trade secret law allows one to sue another who has improperly used secret information obtained in a confidential relationship, it has generally avoided characterizing the information itself as property.[44] Similarly, copyright law attempts to protect expressions but not ideas. The reasons for these distinctions stem not so much from an inability to create property rights in information as from enlightenment era-based views that the free dissemination of information, unencumbered by such rights, would lead to greater wealth, knowledge, and public debate, and to scientific, economic, and technological advancement.

In fact, intellectual property rights are a relatively recent development that most likely would have struck observers from previous centuries as strange.[45] As stated by one eighteenth-century commentator:

> I can read the contents of a book, learn, abridge, expand, teach, and translate it, write about it, laugh over it, find

43. Int'l News Serv. v. Associated Press, 248 U.S. 215, 250 (1918) (Brandeis, J., dissenting).

44. *See* Pamela Samuelson, *Information as Property: Do Ruckelshaus and Carpenter Signal a Changing Direction in Intellectual Property Law?*, 38 CATH. U. L. REV. 365, 365 (1989). While some trade secrets cases do refer to the information in question as property, the more accepted view appears to be that trade secrets are not the property of the entrustor of information. *See id.* at 374.

45. *See* Boyle, *supra* note 18, at 1463, Keith Aoki, *Authors, Inventors, and Trademark Owners: Private Intellectual Property and the Public Domain*, 18 COLUM.-VLA J.L. & ARTS 1, 26 (1994) [hereinafter Aoki, *Authors, Inventors*].

> fault with it, deride it, use it poorly or well—in short, do with it whatever I will. But the one thing I should be prohibited from doing is copying or reprinting it? . . . No, no, it is too obvious that the concept of intellectual property is useless. My property must be exclusively mine; I must be able to dispose of it and retrieve it unconditionally. Let someone explain to me how that is possible in the present case. Just let someone try taking back the ideas he has originated once they have been communicated so that they are, as before, nowhere to be found. All the money in the world could not make that possible.[46]

The rationale underlying the traditional American notion that information should not be privately owned is illustrated by *Int'l News Serv. v. Associated Press* (*INS*),[47] a "controversial and little followed" case that deviates sharply from the traditional American approach to intellectual property.[48] In *INS*, International News Service (INS) had been prevented by foreign governments from cabling news of the war in Europe back to the United States. INS employees instead gathered war information by reading it in Associated Press (AP) newspapers or reading dispatches posted at AP offices and then reprinting the information contained therein. The case is similar to most insider trading cases in that the employees learned of the information primarily through legal means.[49] Justice Pitney, writing for the majority, found that AP had a "quasi-property" right in the information in question. In other words, although after publication news became common property as regards the general public, AP had a property right in the information as against INS.[50] In reaching its ruling, the majority used a classic law and economics argument: news

46. Christian S. Krause, *Uber den Buchernachdruck*, 1 DEUTSCHES MUSEUM 415–17 (1783), *quoted in* Martha Woodmansee, *The Genius and the Copyright: Economic and Legal Conditions of the Emergence of the 'Author,'* 17 EIGHTEENTH-CENTURY STUDIES 425, 443–44 (1984).

47. 248 U.S. 215.

48. Kitch, *supra* note 39, at 699.

49. Apparently some information was obtained from AP employees by unlawful means, primarily bribes. These instances were not before the Supreme Court, however, as INS did not appeal that portion of the trial court decision. *See* INS, 248 U.S. at 231–32.

50. *See id.* at 236. This "quasi-property" right was limited in duration, however. The court ruled that AP's property interest in its published news items lasted "until its commercial value as news to the complainant and all of its members has passed away." *Id.* at 245.

gathering is expensive. If AP could not exclude others from using the information it uncovered and thus capture the profits, then it would have no incentive to create the information and would go out of business. The public would suffer accordingly.[51]

In dissenting opinions, both Justice Holmes and Justice Brandeis disagreed with the Court's property rights in information approach. They argued that not only was such a sweeping approach unnecessary, but also suggested that the Court had failed to consider the significant implications of such a departure from the traditional treatment of information in the American legal system.[52]

Justice Holmes, in an opinion that foreshadows some of the arguments made by today's post-modernist scholars, argued that property rights did not stem automatically from natural law because an item had value.[53] Rather, property rights were creations of law stemming from the belief that the right to exclude others is necessary to protect the possessor from unwanted interference.[54] In this case, however, such a grant of property rights was not necessary because unfair trade law provided adequate protection for AP.[55]

Justice Holmes's thoughts still ring true today. Many intellectual property scholars today are critical of what they perceive as a modern trend toward a greater commodification of information. They express concern that the public domain is increasingly viewed as an intellectual backwater where only ideas undeserving of protection rest, rather than as a default position where information rests until a compelling public policy justifies removing it from the public domain and into private ownership.[56]

51. *See id.* at 240–41.

52. *See id.* at 245–67.

53. *See, e.g.,* Keith Aoki, *(Intellectual) Property and Sovereignty: Notes Toward a Cultural Geography of Authorship*, 48 STAN. L. REV. 1293, 1318 (1996) [hereinafter Aoki, *(Intellectual) Property*] ("Is something valuable because it's legally protected, or is it legally protected because it's valuable?").

54. *See* INS, 248 U.S. at 246 (Holmes, J., dissenting).

55. *See id. See also* Samuelson, *supra* note 44, at 392. This same argument could be made in the insider trading context. There is nothing to prevent issuers from requiring confidentiality agreements from those with whom they transact business. Such contracts could prohibit third parties from trading on information acquired in the course of doing business with the issuer, obviating the need for a grant of property rights in the issuer. *See infra* pp. 711–15 (advocating the privatization of outsider trading law).

56. *See, e.g.,* Jessica Litman, *The Public Domain*, 39 EMORY L.J. 965, 968 (1990) ("The public domain should be understood not as the realm of material that is undeserving of

This perceived trend toward greater information commodification, arguably visible in many recent cases, causes uneasiness among some commentators who believe that a diminished public domain of ideas carries significant negative consequences for social, cultural, technological, economic, and political development.[57] This trend is also arguably visible in the rise of justifications for the insider trading prohibition based on the issuer's property right in valuable inside information, with the same potentially negative impact on the public domain of information and, correspondingly, on market efficiency.

The other *INS* dissenter, Justice Brandeis, also held potential insights for the insider trading debate. In a now famous opinion, he argued against the creation of a property right in the AP news items. Justice Brandeis charged that the majority did not consider the public's interest in vital information—news about the war in Europe. He noted that half the nation read non-AP newspapers and argued that there was an important public interest in affording them a supply of accurate, timely news information.[58]

Justice Brandeis, noting the traditional reluctance of the American legal system to recognize property rights in information, argued that the normal rule was that information and ideas were not subject to property rights and that exceptions were granted—as in the copyright and patent clauses—only by the legislature and only when public policy seemed to demand it.[59] He noted that the legislature was better able to weigh all the factors, engage in the necessary debate and craft carefully limited remedies.[60] Observers

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protection, but as a device that permits the rest of the system to work by leaving the raw material of authorship available for authors to use.").

57. *See* Wendy J. Gordon, *An Inquiry into the Merits of Copyright: The Challenges of Consistency, Consent, and Encouragement Theory*, 41 STAN. L. REV. 1343, 1460–61 (1989); Breyer, *supra* note 40, at 283–84 (arguing against stronger copyright laws); Aoki, *(Intellectual) Property*, *supra* note 53, at 1323–24; Litman, *supra* note 56, at 965–67. The number of scholarly works reflecting concern over increased intellectual property rights and a decreasing public domain in American law is too numerous to cite here. A more thorough citation and survey is available in Aoki, *Authors, Inventors*, *supra* note 45, at 8–10.

58. *See* INS, 248 U.S. at 263–64.

59. *See id.* at 250 (Brandeis, J., dissenting).

60. *See id.* at 266–67. One alternative, for example, that would encourage the dissemination of information yet still provide AP with a profit would be a rule that protects AP's news against appropriation by competitors, but forces AP to disclose the information to others at a reasonable price and without discrimination. *See id. See also* Samuelson, *supra* note 44, at 366–67 (arguing that the recharacterization of information as property is a revolutionary event that, at the very least, should be undertaken after

of recent developments in insider trading regulation make similar arguments, believing that current insider trading law, and the misappropriation theory in particular, is a misguided judicial attempt to regulate informational asymmetries in the absence of legislative guidance.[61]

V. THE PRIVATIZATION OF OUTSIDER TRADING—THE PROMISE OF STATE CONTRACT LAW

Although it is unnecessary to incentivize issuers to produce valuable inside information, the need to encourage the dissemination of such information to the marketplace has been the topic of extended discourse for many years.[62] Clearly, a rule that required issuers to disclose all material nonpublic information (an "always disclose rule") would most fully achieve both informational efficiency and informational equality.[63]

Accordingly, if increased corporate disclosure and fairness in access to information among securities market participants is the desired goal, then disclose-or-abstain theories of liability, including the classical and misappropriation theories of insider trading, fall short of achieving that objective.[64] Because a disclose-or-abstain

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thorough thought and careful debate—not accidentally and in an ad hoc manner by judges intent on reaching what they perceive to be an equitable result).

61. *See, e.g.*, Richard W. Painter, Kimberly D. Krawiec & Cynthia A. Williams, *Don't Ask, Just Tell: Insider Trading After* United States v. O'Hagan, 84 VA. L. REV. 153, 156 (1998). Professor Stephen M. Bainbridge, while acknowledging that the current insider trading regime was not authorized by Congress, has skillfully argued that the costs of changing course at this juncture are so great that insider trading regulation should be permitted to continue down its current "path dependent" course, with some doctrinal modifications. *See* Stephen M. Bainbridge, *Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud*, 52 SMU L. REV. 1589, 1589–91 (1999) [hereinafter Bainbridge, *Path Dependence*].

62. *Compare* Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 682–84 (1984) (arguing that managers have sufficient market incentives to encourage corporate disclosure without mandatory disclosure regulations), *with* John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 722–23 (1984) (arguing that a mandatory disclosure system is needed), *and* Joel Seligman, *The Historical Need for a Mandatory Disclosure System*, 9 J. CORP. L. 1 (1983) (presenting historical evidence of fraudulent disclosure and under-disclosure prior to the enactment of the Securities Acts).

63. *See* Gilson & Kraakman, *supra* note 19, at 632 n.218; Saul Levmore, *Securities and Secrets: Insider Trading and the Law of Contracts*, 68 VA. L. REV. 117, 119–20, 126 (1982).

64. The "disclose or abstain" rule was first articulated by the Commission in *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961). The Commission held that a corporate insider in possession of material nonpublic information must either disclose that information or refrain from trading. *See id.* The rule was later expanded under the misappropriation

rule permits the corporation and its insiders to withhold relevant information so long as they do not trade in the corporation's securities, a disclose-or-abstain rule encourages abstention, rather than disclosure.[65] This affords insiders an informational advantage over outsiders: so long as relevant information affecting stock prices remains undisclosed, outsiders trade blindly in a market that may not accurately reflect stock value.[66] By contrast, insiders will know to refrain from trading until the market is well-informed.[67]

There are, of course, numerous reasons to reject an always-disclose rule despite its advantages in terms of informational efficiency and equality, and the Supreme Court has on several occasions explicitly rejected the idea that corporations owe a general duty to disclose relevant information to the marketplace.[68] In fact, nearly every commentator that has studied the issue has rejected an always-disclose rule as impractical.[69] In particular, it has been noted that while the always-disclose rule would result in

theory to cover persons who acquired nonpublic information in breach of a fiduciary duty. *See* United States v. O'Hagan, 521 U.S. 642 (1997).

65. *See* Easterbrook, *supra* note 20, at 327 (noting that a disclose or abstain rule results in abstention, not disclosure, and consequently does not encourage the release of relevant information to the market); Levmore, *supra* note 63, at 123; Bainbridge, *Path Dependence*, *supra* note 61, 1608–09 (arguing that current insider trading law's disclose or abstain rule "collapses into a rule of abstention" because agency law prevents the firm's agents from disclosing corporate information that would be harmful to the corporate principal); Charles C. Cox & Kevin S. Fogarty, *Bases of Insider Trading Law*, 49 OHIO ST. L.J. 353, 353 (1988) ("The 'abstain or disclose' rule for those entrusted with confidential information usually is observed by abstention.").

66. *See* Levmore, *supra* note 63, at 123.

67. *See id.* at 123–28. The example used by Professor Levmore as illustration is *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (1968). In *Texas Gulf Sulphur*, the corporation had information indicating that a valuable ore deposit made the company's shares more valuable than the market realized. Insiders were aware of this, and therefore knew not to sell their shares into the undervalued market. Outsiders, however, were unaware of these facts and, therefore, may have continued to sell their shares at less than fair value. *See* Levmore, *supra* note 63 at 123. Professor Levmore recognized that outsiders as a group may not be harmed by the disclose or abstain rule because it is just as likely that some shareholders may have purchased undervalued shares as it is that some shareholders may have sold undervalued shares. *See id.* at 123. Nonetheless, he argued that the rule is ultimately unfair to outsiders because they are forced to trade "randomly" risking the misfortune of trading in an uninformed market, while insiders could abstain and avoid these risks. *See id.* at 123–24. While the disclose or abstain rule would not place the Texas Gulf Sulphur investors on an equal informational footing with insiders, therefore, an always disclose rule would. *See id.* at 124–28.

68. *See* Basic Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988) ("Silence, absent a duty to disclose, is not misleading under Rule 10b-5."); Chiarella v. United States, 445 U.S. 222 (1980) (holding that a duty to disclose does not arise from the mere possession of material nonpublic information); Dirks, 463 U.S. 646, 654–55 (1983) (same).

69. *See* Levmore, *supra* note 63, at 132.

greater informational efficiency, it could also result in allocative losses to shareholders by forcing the disclosure of information that could benefit competitors or jeopardize corporate plans.[70]

Given these problems with mandated disclosure of material information, a rule that encourages transmission of information to the marketplace without actual disclosure holds the promise of promoting both allocative and informational efficiency. In fact, many commentators who have advocated a rule permitting insider trading have defended their proposal on exactly these grounds.[71]

The speed and efficiency with which insider trading transmits information to the marketplace is somewhat unclear.[72] Although there is little empirical evidence available on the topic, there is also little doubt that insider trading is not as effective a means of transmitting information to the marketplace as is actual disclosure of the relevant information. The decoding of insider trading activity performed by savvy investors is a relatively slow and noisy process by comparison. Nonetheless, given that immediate disclosure of nonpublic corporate information is normally not required by federal securities laws and in many cases would jeopardize legitimate business plans, a scheme that allowed outsider trading based on material nonpublic information could perhaps provide the next best alternative.[73]

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70. For example, disclosure of an impending tender offer could jeopardize the success of such an offer by attracting rival bidders or alerting the target to implement takeover defenses. Similarly, disclosure of new products or procedures would alert competitors of impending plans and jeopardize first-mover advantages. Returning to the example of *Texas Gulf Sulphur*, a rule that forced Texas Gulf to disclose the secret ore deposits would have resulted in a more accurate price for Texas Gulf Sulphur stock, but also would have destroyed the opportunity for the valuable land sale purchase, resulting in a huge loss for the Texas Gulf Sulphur shareholders. *See* Levmore, *supra* note 63, at 135–36. Furthermore, an always disclose rule may reduce the incentives to produce valuable information, such as the ore deposits discovered—at great expense—by Texas Gulf Sulphur, raising further issues of allocative efficiency. *See* Gilson & Kraakman, *supra* note 19, at 632 n.218.

71. *See, e.g.*, Gilson & Kraakman, *supra* note 19, at 632–33 n.221.

72. *Compare* Richard W. Painter, *Insider Trading and the Stock Market Thirty Years Later*, 50 CASE W. RES. L. REV. 305, 308 (1999) (stating that "the insider trader makes market prices more accurately reflect all available information"), *and* Jonathan R. Macey, *Securities Trading: A Contractual Perspective*, 50 CASE W. RES. L. REV. 269, 275–76 (1999) ("Economists generally agree that insider trading will generally lead to more accurate stock prices . . . ."), *with* Gilson & Kraakman, *supra* note 19, at 630–32 (arguing that insider trading transmits relevant information to the marketplace slowly and inefficiently and, absent a rule requiring insiders to disclose their trades, is unlikely to substantially further market efficiency).

73. Contrary to other scholars who have advocated a privatization of federal insider trading law, this article does not advocate contractual solutions to the problem of insider

Accordingly, this article advocates a privatization of outsider trading law, by essentially repealing the misappropriation theory, while retaining the classical theory of insider trading liability. Under this proposed regime, federal securities law would permit insider trading by corporate outsiders, defined as persons who are neither employees nor constructive insiders of the issuer and who did not receive their information in a tip from such a person. Such a regime provides the hope of filling in the gaps of the current disclose or abstain system, by encouraging the reflection of inside information in stock market price without requiring direct disclosure of the information. Furthermore, this regime leaves unchanged federal law governing the trading and tipping activities of real and constructive insiders who often control the issuer's information flow to the outside world. Accordingly, this proposal avoids the perverse incentives and negative impacts on market efficiency attendant in a system that permits trading by such parties.

Because the SEC will continue to monitor trading activity in order to detect illegal trading by corporate insiders, its monitoring expertise can be employed to assist issuers in the enforcement of private contracts restricting the use of inside information by corporate outsiders. In other words, because SEC investigations of unusual stock price movements are likely to reveal insider as well as outsider trading activity, the SEC could share information

trading by actual or constructive corporate insiders. *See, e.g.*, Haddock & Macey, *Coasian Model*, *supra* note 4 (advocating an opt-in approach to insider trading regulation). A system that permits corporate insiders to profit from informed trades creates perverse incentives that may actually reduce market efficiency. For example, allowing insiders to profit from their access to inside information may encourage market manipulation and the delay of public disclosure of relevant information. Furthermore, it is unlikely that market forces would act to constrain decisions to opt out of insider trading laws that are not in shareholders' best interests. It has been noted that the markets for corporate control and managerial labor tend to fail with respect to issues involving significant redistribution of wealth from shareholders to managers, as in the case of insider trading. *See* Lucian A. Bebchuck, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1462–65 (1992). *See also* Henry N. Butler, *The Contractual Theory of the Corporation*, 11 GEO. MASON L. REV. 99 (1989) (arguing that market forces do not adequately constrain managers during "last-period" problems, when the benefits of a certain action substantially outweigh any penalties imposed by the managerial labor market). Similarly, evidence indicates that legal changes negatively impacting shareholder welfare are not accurately reflected in share price. *See* Elliot J. Weiss & Lawrence J. White, *Of Econometrics and Indeterminacy: A Study of Investors' Reactions to "Changes" in Corporate Law*, 75 CAL. L. REV. 551 (1987).

regarding outsider trading activity with the issuing corporation, thus easing the costs of private enforcement.[74]

A regulatory system that privatized the law of outsider trading also provides advantages over existing federal law in terms of clarity. Unlike the regulation of outsider trading under the misappropriation theory, which leaves the determination of when an outsider has traded in violation of a "duty of trust and confidence" to an almost case-by-case analysis, privatizing outsider trading lends clarity to the regulatory scheme by permitting, under federal law, all outsider trading that does not involve an insider tip.[75] Instead, such trading would give rise to civil liability under state law when it violates an express (though not necessarily written) agreement.

Nonetheless, the clarity benefits of this proposal should not be overstated. Many insiders will almost certainly attempt to evade the federal insider trading prohibition by trading through or tipping friends and family members and then arguing that these illegal insider trades are actually misappropriations that are governed by state contract law. In such circumstances, an express agreement regarding use of the inside information is unlikely, as presumably the outsider would refuse to risk civil liability under state law by engaging in a scheme that violates an express agreement.

Although allowing the SEC to bring a cause of action when it believes that illegal insider trading activity is being disguised as a misappropriation could prevent some of the more egregious cases, the burden of proof should be on the government to prove that such a scheme to evade federal law exists. Accordingly, some insider trades are likely to escape regulation by both federal and state law. Nonetheless, this author is prepared to accept these costs as being outweighed by the benefits of deregulation.

To illustrate how this proposed regime differs from current insider trading law, assume that Husband, a CEO in a major telecommunications company, tells Wife that Husband's company is about to be acquired by a competitor at a substantial premium over the current market price. Husband tells Wife that the

74. *See* Larry E. Ribstein, *Federalism and Insider Trading*, 6 SUP. CT. ECON. REV. 123, 170 (1998) (arguing that misappropriation cases should be governed by state law, but that the commission should share information regarding outsider trading with issuers and state regulators, as the FBI shares information with state law enforcement agencies).

75. *See* Painter, Krawiec & Williams, *supra* note 61, at 156 (criticizing the misappropriation theory adopted by the Supreme Court for lacking sufficient clarity).

information is not yet public, and that he is sharing the information with her so that she can prepare for Husband's change in employment that will be necessitated by the acquisition. Wife trades in the information, netting a large profit.

Under current insider trading law, this case would be treated as a misappropriation by Wife of information belonging to Husband. As such, Wife's liability as an insider trader would not be automatic, but would turn on whether the relationship between Husband and Wife was one of "trust and confidence." This issue is often very unclear and most likely would require the court to engage in extensive—and costly—fact finding.[76]

Under the regulatory regime proposed in this article, federal law would not govern Wife's trading activity, as she is neither an insider nor constructive insider and did not receive her information in a tip from Husband. Accordingly, any harm suffered by the information source—Husband—must be redressed by state contract law, or more likely, by informal family mechanisms.

Needless to say, absent significant expenditures of time and money by the SEC, this proposal shifts a large portion of the responsibility for monitoring outsider use of inside information to private parties, but that is exactly the intention of this proposal.[77] Current outsider trading regulation is expensive, ineffective and siphons limited resources away from federal projects that could perhaps make better use of such funding.[78] To make matters worse, the injuries caused by outsider trading and the benefits provided by its prohibition are, at best, amorphous, and it is

76. *See, e.g.*, United States v. Chestman, 947 F.2d 551, 568 (2d Cir. 1991) (finding that the relationship between husband and wife is not by definition one of trust and confidence); United States v. Reed, 601 F. Supp. 685 (S.D.N.Y. 1985) (finding that although the relationship between father and son is not necessarily one of trust and confidence, facts may be shown demonstrating that it is).

77. Professor Bainbridge has cogently argued against the privatization of insider trading law on precisely these grounds. *See* Bainbridge, *Path Dependence*, *supra* note 61, at 1625 (arguing that Professor Ribstein's arguments in favor of private enforcement are unpersuasive). Nonetheless, this author remains convinced that the costs of current federal outsider trading regulation outweigh any potential benefits.

78. Empirical evidence indicates that, although U.S. regulators have experienced great success in deterring illegal insider trading by classical and constructive insiders, U.S. regulatory efforts have been largely ineffective in deterring illegal outsider trading. *See* Nasser Arshadi, *Insider Trading Liability and Enforcement Strategy*, 27 FIN. MGMT. 70, 70 (1998) (finding that insider trading regulation in the United States has been reasonably effective at deterring trades by "registered and temporary insiders," but has failed to deter illegal insider trading by corporate outsiders).

unclear whether any benefits of current federal outsider trading regulation (in terms of maintaining investor confidence in the markets and increasing market liquidity) outweigh the costs of enforcement and decreased informational efficiency.[79] Accordingly, until regulators further analyze the costs and benefits of outsider trading regulation, this article proposes that the regulation of such trading be left to private contract.

79. *See* Kimberly D. Krawiec, *Fairness, Efficiency & Insider Trading: Deconstructing the Coin of the Realm in the Information Age*, 95 NW. U. L. REV. 443 (2000) (discussing at length the alleged harms suffered by investors due to insider trading and concluding that, although sound policy reasons exist for the federal prohibition against insider trading by the issuer's employees and constructive insiders, the costs of the federal prohibition against outsider trading outweigh the minimal benefits provided by the prohibition).